

# Solid State

**Technology**
**10 September 2019**

## Management raises FY20 profit guidance

In our July update, we noted there was scope for Solid State to upgrade FY20 guidance depending on Pacer's performance and margin contribution from individual manufacturing contracts. After a strong start to the year, management has announced that FY20 profits will be significantly ahead of expectations, while revenues remain in line with the original consensus. Consensus FY20 and FY21 EPS estimates have been raised by 14% and 9%, respectively. The shares continue to trade at a substantial discount to peers for prospective P/E.

## Trading in first four months ahead of budget

Several factors are having a favourable impact on profits. One-offs are the shift of some projects from H220 into H120, meaning the full-year performance will be first-half weighted, and the positive exchange rates, which may reverse later in the year. Other factors are sustainable. These include a transition to higher added-value projects and continuing production efficiencies in the Manufacturing division together with operational leverage across the group related to higher activity levels. Pacer, a value-added distributor of opto-electronic components and displays, continues to perform strongly and ahead of management expectations since its working capital constraints were removed following its acquisition by the group in November 2018.

## Margin improvement linked to strategic actions

We see the recent profit upgrade as an outcome of management's programme to create scale in both divisions through acquisitions such as Pacer last year and customised batteries business Creasefield in June 2016. This gives the group operational leverage and helps secure new distribution franchises. The creation of centres of excellence in the Manufacturing division – Power at Crewkerne, Communications in Leominster and Computing in Redditch – has helped drive production efficiencies and focus each activity on higher-margin business.

## Valuation: Trading at a discount to peers

Despite the consensus upgrade, the share price is lower than the 507.5p peak in early August. The shares continue to trade on prospective consensus P/E multiples at a substantial discount to the mean for both our sample of specialist manufacturing companies (11.2x for Solid State vs 18.7x for peers) and our sample of value-added distributors (11.2x vs 19.0x). We note scope for further upgrades linked to incremental sales later in the year.

### Consensus estimates

Year end	Revenue (£m)	PBT* (£m)	EPS* (p)	DPS (p)	P/E (x)	Yield (%)
03/18	46.3	3.0	30.9	12.0	15.3	2.5
03/19	56.3	3.5	35.9	12.5	13.1	2.6
03/20e	68.0	4.2	42.2	13.9	11.2	2.9
03/21e	70.9	4.4	44.0	14.6	10.7	3.1

Source: Company data, broker consensus. Note: \*Adjusted for exceptionals, share-based payments and amortisation of acquisition intangibles.

**Price** 472p  
**Market cap** £40m

### Share price graph



### Share details

Code SOLI  
Listing AIM  
Shares in issue 8.5m

### Business description

Solid State is a high value-add manufacturer and specialist design-in distributor to the electronics industry. It has expertise in industrial/ruggedised computers, electronic components, antennas, microwave systems, secure communications systems and battery-power solutions.

### Bull

- Added-value design capability supports long-term relationships with customers and higher margins.
- Pacer acquisition adds to value-added distribution portfolio with little overlap.
- Scale attracts new franchises such as Microchip and VPT.

### Bear

- Revenue development dependent on OEM customers' sales and marketing activity.
- Interest on loan to fund Pacer transaction a drag on profits.
- Delays affecting high value-added manufacturing projects for government-funded and major infrastructure programmes are commonplace.

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